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August 2008 – Special edition

Audit

IAS Plus.

Published for our clients and staff throughout the world

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A common denominator

IASB and FASB issue proposed amendments to Earnings per Share

On 7 August 2008, the International Accounting Standards Board (IASB) published for public comment an Exposure Draft (ED) of proposed amendments to IAS 33, **Simplifying Earnings per Share.** The ED was issued simultaneously with a proposed amendment to FAS 128 Earnings per Share, the US GAAP equivalent. Both proposals are part of the ongoing convergence project between the IASB and the Financial Accounting Standards Board.

What is converged?

The basis of conclusions to the ED acknowledges that the numerator, i.e. earnings, will continue to be different between IFRSs and US GAAP. The aim of the ED is to eliminate some existing differences in determining the **denominator,** i.e. the number of shares, where these differences are capable of resolution in a relatively short time and can be addressed outside current and planned major projects.

The ED aims to converge:

- the basic principle of determining what instruments are included in basic EPS. The ED proposes that only ordinary shares that give (or are deemed to give) the holder the right to share currently in profit or loss of the period should be included in the calculation of basic EPS. Ordinary shares include ordinary shares that are currently issuable for little or no cash or other consideration. The treatment for many mandatorily convertible instruments will change. Currently under IAS 33 these instruments are likely to be treated for EPS purposes as if the instrument has already been converted, i.e. the shares have been issued, whereas under the ED this will not be the case if the holder of the instrument does not have the right to immediately convert as the holder does not currently share in profit or loss of the period. Also, in determining the amount of earnings attributable to ordinary shares an entity shall consider the effects of a second class of ordinary shares and participating instruments.
- the EPS impact for contracts that require the entity to buy back its own ordinary shares for cash or other financial assets that are not fair valued through profit or loss, e.g. some forward purchase contracts over own equity. It proposes to treat those contracts as if the entity had already repurchased the shares, therefore as a reduction in the number of ordinary shares outstanding. This would also apply to mandatorily redeemable ordinary shares. If the underlying shares to be acquired are receiving dividends it may result in the financial liability being considered a participating instrument.
- the EPS treatment of participating instruments that are classified as financial liabilities. IAS 33 currently only takes into account participating instruments that are classified as equity when determining the amount of earnings and number of ordinary shares. The ED proposes extending this to participating instruments that are classified as financial liabilities if they are not fair valued through profit or loss.

- the calculation of diluted EPS for participating instruments and two-class ordinary shares. The ED proposes that in determining whether a participating instrument or a second class of shares convertible into ordinary shares is dilutive, the entity must calculate dilutive EPS assuming both conversion does and does not occur. Diluted EPS reflects the more dilutive of these scenarios.

What is simpler?

The ED proposes that if an instrument (or part of an instrument in the case of an embedded derivative that is separated) is fair valued through profit or loss and may result in the issue or acquisition of ordinary shares in the future, then no adjustment is required to earnings or the number of shares for either basic or diluted EPS. As the instrument's fair value is already recognised in current earnings, thereby impacting current equity holders, no further adjustment is required to earnings or the number of shares. This proposed change in treatment will be relevant to all standalone derivatives over own equity that under IAS 32 are not classified as equity instruments and to convertible debt where the embedded conversion option into own equity fails to meet the definition of equity.

In determining whether an option, warrant, or equivalent is dilutive, the existing standard looks to the average share price for the period. The ED proposes that the period end share price should be used instead. The ED also clarifies that in determining whether a forward sale contract over own equity is dilutive the treasury stock method should be used, which is the same method used for options and warrants.

The ED proposes removing the guidance on determining whether forward purchase contracts or written puts over own equity are dilutive. The ED presumes that these are either fair valued through profit or loss and therefore not adjusted for EPS purposes, or else may be participating instruments if a financial liability is presented for the present value of the redemption amount and dividends are still payable under the shares to be acquired.

The ED proposes clarifying that if a supplementary EPS is disclosed using a different amount of earnings than is required by the Standard, then this may only be disclosed in the notes and not presented in the statement of comprehensive income. The ED does not propose additional disclosures beyond those required in IAS 33.

When does it apply?

The effective date of these amendments has not yet been determined. The IASB's project plan anticipates a revised standard in the second half of 2009. The IASB has requested comments on the ED by 5 December 2008.

Designed and produced by The Creative Studio at Deloitte, London. 26082

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